#7 (311), 27 February 2006
A publication of the International Centre for Policy Studies

ICPS newsletter®

Ministries ignore invitation from metal industries to talk

The best days of Ukraine's metal industries look gone for good. Eventually, domestic companies will face oversaturated world markets, stronger competition on the domestic market, and rising prices for inputs against shrinking prices for output. Additional problems for the metal industries are depreciating plant, unpaid VAT refunds and excess labor. Metal producers want the Government to identify its policy in the steel sector and to eliminate restrictions on infrastructure and foreign trade that hamper development. Unfortunately, representatives of profiled ministries who were invited to a recent roundtable on this issue failed to attend

On 31 January 2006, the International Centre for Policy Studies and the Center of Public Relations held a roundtable called "Ukrainian Metals: What are their prospects?" Its goal was to organize a dialog involving the Government, directors of metal enterprises and associations, metallurgists, and sector specialists in analyzing prospects for the metal sector's development, government policy options in this area, and solutions to current problems.

Roundtable participants included experts, metallurgists, and representatives of the largest companies in this sector—Yenakiyevo Steelworks, the Industrial Group consortium, the Ukrainian Association of Ferrous Metal Manufacturers, and Tsentralniy Ore Mining and Enrichment. However, the ministers who had been invited to participate did not dispatch specialists from their ministries to attend. Such a response on the part of the Government can be interpreted as a lack of readiness for open communication and exchange of ideas, lack of an official position on new policy or even a lack of understanding of the need for stakeholders to communicate with the Government.

Factors affecting the future of Ukraine's metal industries

Since China sharply increased its own steel production capacities, Ukrainian producers have been facing losses in their customary markets, shrinking global prices and cutbacks in steel output. The Ukrainian–Russian conflict in the gas sector also threatens to cut into the profit margins of certain types of metal products. Producers are finding themselves in a major price squeeze: prices for gas, power and other inputs are growing significantly, while prices for their products are dropping. Metal producers say that the steel sector will be affected by five factors in the next few years:

Overproduction. New capacities are actively going on line around the globe, but metal consumption is not growing as rapidly due to an overall slowdown in economic growth. According to estimates by Yenakiyevo Steelworks Director Ihor Korytko, surplus global capacities were about 63mn tonnes in 2005, a figure that could grow to 200mn t by 2008. Stronger competition will mean lower capacity utilization and reduced profitability.

Stronger competition on the domestic market. Imports of metal products into Ukraine will continue to grow. In 2005, metal imports reached 1mn tonnes, a 26% growth year-on-year, according to data from Oleksandr Siryk, Director of Marketing and Consulting under the State Information and Analytical Center for Monitoring Foreign Commodity Markets. Mr. Siryk warned that, next year, steel made in China will be sold on the Ukrainian market. Meanwhile, Russia's policy of active import substitution will likely mean that Ukrainian producers will be shut out, not only on the Russian market, but also on global markets.

Cost inflation. Price increases on inputs, primarily gas, will pose a problem for this sector. Producers say that a gas price of US $100–105 per 1,000 cu m, excluding transportation costs, would lead to significant adjustments in their investment programs and a likely reduction of output and, of course, profitability. If the price for gas, excluding transportation, reaches US $150–160 per 1,000 cu m, producers could find themselves on the verge of a complete production shutdown.

Globalization. According to Industrial Group Vice President Viktor Panteleyenko, the coming of India's Mittal Steel to Ukraine is a significant event that reflects the globalization of the steel industry. So far, Ukraine has stood outside these processes.

Stricter environmental regulation and more expensive labor. According to Yenakiyevo's Korytko, the Ukrainian steel industry has two temporary competitive advantages: lack of strict environmental legislation and a highly qualified and relatively inexpensive labor force. Both factors will gradually disappear.

Problems inside the steel sector

The country's metal producers are dissatisfied with government policy in the steel sector. Among the policies that stymie the development of this sector, steel manufacturers mentioned higher freight rates on the railroad, the appreciation of the hryvnia, and the unsuccessful resolution of the gas issue. Metal producers say that the sector is often viewed as a "cash cow" that will continue to provide money to patch up holes in the State Budget. Other problems in this sector include:

VAT refund arrears. When the government fails to refund VAT, the working capital of steel manufacturers is reduced and, thus, opportunities to buy raw materials and other inputs, pay wages and invest. According to the Volodymyr Kozachenko, president of the Ore Mining and Enrichment Trade Union, VAT refund arrears grew UAH 52mn in 2005 and are now UAH 1.5bn.

Excess labor. Ukrainian metal producers inherited a soviet human resource policy whose main purpose was not to be efficient, but to employ as many people as possible. With prices for energy resources on the rise and new technologies actively being introduced, it is impossible to guarantee that excess workers will be laid off gradually. At the same time, the unions say they were prepared to agree to cutbacks, provided the released money remained in the payroll fund. Mr. Kozachenko noted that every percentage point of growth in productivity needs to result in a 0.7–0.8% increase in wages. For this reason, he said, Europe has productivity rates that are 17–20 times higher than Ukraine's and wages that are 25–30 times higher than the Ukrainian wages.

Poor quality raw materials. According to metallurgists, one problem with developing the metals industries is that the raw material reserves that have been explored in Ukraine are primarily suitable for producing steel in blast furnaces, which is outdated. The quality of Ukrainian iron ore is low, below the quality of products manufactured by Russian ore mining and enrichment plants. However, Ukrainian steelmakers say this quality is compensated for by the closeness of ironworks to steelworks and the active measures iron ore producers are currently taking to improve their quality.

Depreciated fixed assets. The high depreciation of plant (70–80%) and the domination of outdated technologies in the sector have made the sector vulnerable to price hikes for energy resources.

Two development strategies for the sector

Participants in this roundtable were not able to come up with a single conclusion as to which direction the sector should take. Leonid Haletskiy, department head at the Institute of Geological Sciences under the National Academy of Sciences is convinced that the country needs to radically upgrade this sector and change development goals altogether. Mr. Haletskiy said the most effective option for developing the Ukrainian steel industry is to integrate resources and high technologies. He added that Ukraine needs to take advantage of its raw materials base of rare earth and precious metals. In addition to technological steps such as switching to a converter production process and continuous steel casting, developing a quality steel sector in Ukraine means switching to alloyed steel, non-ferrous and rare metals.

On the other hand, Serhiy Zhuchkov, Deputy Director for Scientific Research of the Institute of Ferrous Metals under the NAS, made the assumption that Ukraine's industry needs to continue along the current path, but it must actively introduce energy-efficient technologies.
Mr. Zhuchkov said Ukraine does not have the option of injecting massive capital to reorganize the metal sector. So the answer to costlier natural gas must be a search for alternative, more convenient and low-energy technologies.

How the Government could help

The Minister of Industrial Policy, the Minister of Economy and the Minister of Fuel and Energy, who were invited to this roundtable, did not send their ministry specialists to attend this event. This meant that the government position was not presented at this roundtable and stakeholders did not have an opportunity to establish a proper dialog. Nevertheless, participants identified three key requests to the Government:

Identify an economic development strategy. Dmytro Bilokurov, General Director of the Ukrainian Association of Ferrous Metal Manufacturers, "There is currently an impression that nobody among those who are running the country has a clear picture of where we are supposed to be, say, by 2030. Without understanding the country's overall development strategy, in which the steel sector must be treated as an integral part, we will continue to tread water without getting anywhere."

Develop transportation infrastructure. The ore mining and enrichment sector is one of the main users of transport networks: metal products, coal and iron ore are all transported by rail. Participants noted that the Government was not dealing with its depreciated rolling stock and rail networks. As a way out, steel manufacturers proposed setting up conditions for private carriers to become involved. This means the Government must: (1) establish a level playing field for private businesses, specifically to stop covertly subsidizing UkrZaliznytsia, the national rail transport monopolist, from the Budget and cross-subsidizing passengers at the expense of freight; and (2) provide incentives for businesses to invest in rolling stock through a suitable rail rate policy. Currently, UkrZaliznytsia applies discriminatory rates to cars belonging to private carriers.

Open access to foreign markets. Access to foreign markets is a key factor in developing the steel sector. The metal industry is hoping for Government support in entering new international markets. Metal producers view Ukraine's accession to the WTO as an opportunity to defend their interests in a civilized manner and gain the same access to commodity markets as other countries. Currently, Ukrainian metal producers have heavily restricted access to EU and Russian markets. According to participants, the only negative impact of Ukraine's accession to the WTO for this industry will be the cancellation of export duty for scrap metal. ■

Materials from the roundtable called "Ukrainian Metals: What are their prospects?" and a detailed report can be found online at: http://www.icps.kiev.ua/project.html?pid=100 (in Ukrainian). For more information, please contact Ildar Gazizullin by phone at (380-44) 484-4400 or via e-mail at igazizullin@icps.kiev.ua.

By the way...

- Ukrainian and French politicians discussed on 23 and 24 February political aspects of cooperation between the two countries at a conference called "Ukraine and France: Partnership for Europe" organized by ICPS jointly with the Embassy of France in Ukraine and the Robert Schuman Foundation.
- As part of the "Public Health Watch" project, ICPS organized on 24 February the first public debate on a first draft report on how the Ukrainian Government is carrying out its commitments to combat the HIV/AIDS epidemic. The preliminary conclusion of experts was that legislation and targeted programs that have been approved are not being carried out because of underfunding.
- ICPS specialists prepared and submitted to a Bill "On the National Depository System of Ukraine" along with a rationale. This was commissioned by the National Depository of Ukraine.
- The project called "Ideal Country" launched by the Bloc of Yulia Tymoshenko at *http://www.kraina.org.ua* (in Ukrainian and Russian) includes materials from ICPS. ICPS reports on regional policy, reforms to the law enforcement system, tax policy, the civil service, and the residential services sector, and legitimizing the shadow economy over 2000–2005 were selected as expert opinion on issues discussed on this website.

icps newsletter is a weekly publication of the International Centre for Policy Studies, delivered by electronic mail.
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